

COMMISSIONER KRUEGER: Thank you very much.
Commissioner Rumsfeld.

COMMISSIONER RUMSFELD: Dr. Tyson, Dr. Friedman mentioned these two revolutions, the information revolution and the political revolution, and said that they would make restricting trade, whether on the front side or the back side, very difficult. Your written statement appeared to me to be almost a continuum from where we've been over recent decades, and seems not to reflect either of those revolutions, or any impression that it's going to be more difficult to have these arrangements work the way they've been working in the past. Do you see any discontinuity that we can expect coming up, as he suggested?

MS. TYSON: Well, I didn't hear everything he said, so I'm not sure which discontinuity he was talking about. I think that what I would stress by looking at the 1990s is the extent to which things that I would not myself have thought would occur have occurred. That we have been able to take some major parts of what clearly was in our national competitive interests, such as world telecom and the software -- the information technology agreement, and basically get sectoral agreement which really improve for the U.S.

access to markets for products and markets for services around the world that are just huge.

And I think that what I would say is rather than a discontinuity, we had growing -- since the end of World War II, trade has been growing faster than global output. The world has become more interdependent. The U.S. became even more interdependent and open in the 1990s, but we also managed, during this period of time, to attack kinds of trade impediments which I think were particularly disadvantageous to us. So, I don't -- I don't see a discontinuity. I think it's a continuation of growing openness that I think is played out in a way which has been beneficial.

COMMISSIONER RUMSFELD: I have two other brief questions. On the last page of your written testimony you mention an increase in private sector savings rate.

MS. TYSON: Yes.

COMMISSIONER RUMSFELD: Do you have any statistics?

MS. TYSON: No, and I'm afraid that this is a real issue. If I had to say the most serious issue for the U.S. right now, I wouldn't talk about the trade deficit, I would talk about the build up of debt, of private sector debt and private sector borrowing and

the fact that we had a huge run up in the value of the stock market and people have borrowed against that. Companies have borrowed to retire their stock. They incurred debt to do that. And households that incur debt to enhance their consumption, based on the view that their stock portfolio will allow them to service this debt and maintain this debt.

So, the biggest weakness and the biggest point of vulnerability I see in the U.S. economy right now has to do with the declining private sector savings rate, and the reverse side of that coin, which is the accumulation of debt by the private sector. We've had this odd thing where the government has started to increase its savings and bring down debt, and the private sector has responded by doing the opposite.

The problem is that there are no easy fixes here. One way we could do this, which would be totally politically unpalatable, I believe, but I'll say it. You know, we talk about the Social Security crisis or the Medicare crisis. One thing one could do is one could force additional savings on households and allow the households to invest those savings as they saw fit, but they would be required to save additionally. Now, I don't think that's likely to happen, but that is something that would work.

COMMISSIONER RUMSFELD: Last question. Is there any size of the deficit absolute or percentage that worries you?

MS. TYSON: The trade deficit, or the current account deficit? No. I think that Catherine Mann, who spoke to you, got it right when she said there's no theory, there's no magic number. Numbers that when you get into the three percent range and you're moving up and the direction is the wrong direction, I think you begin to worry about the sustainability of it. Now, what does it mean to be non-sustainable? It means that something will give in the system to make the adjustment. If no policy changes are made, if the rest of the world doesn't pick up its growth rate but sort of continues to limp along, the most then I think the trade imbalance in the U.S. will basically stay the way it is if the rest of the world starts to pick up. This is what I said. Then I think you can imagine it will gradually come down, through the positive benefits of stronger markets abroad.

The way it could play out to inflict some pain on the U.S. would be a weaker dollar, higher interest rates, and slower growth.

COMMISSIONER RUMSFELD: Thank you.

COMMISSIONER KRUEGER: Commissioner Papadimitriou.

VICE CHAIRMAN PAPADIMITRIOU: Thank you very much. Dr. Tyson, it seems to me that there's some incompatibility in terms of the causality of the trade deficit --

MS. TYSON: Yes.

VICE CHAIRMAN PAPADIMITRIOU: -- and the U.S. economic expansion. We've heard from Professor Friedman earlier that the trade deficit actually, in summary, is a good thing because it has provided the investments that are the financing of the investments in the U.S.

MS. TYSON: Yes. Put money into the U.S.

VICE CHAIRMAN PAPADIMITRIOU: Right. But yet I think that from your statement, perhaps I didn't get it right, you're suggesting that it is the growth of the U.S. economy that it is really the result of the deficit, that in fact we, as a growth economy, can afford to have -- to incur a deficit. Is that right?

MS. TYSON: Well, the problem is that these things are determined simultaneously. So, the causality is very hard and, in fact, I think, incorrect to sort of do causality unilaterally.

There are many reasons why the U.S. economy has expanded in the 1990s. We had a change in fiscal

policy and a change in monetary policy which created a better environment for investment in the United States.

We had a major technological revolution unfolding in the United States. We had a massive effort by much of the American business community to restructure based on competitive challenges that they had confronted in the 1980s.

So, there are a number of domestic reasons why the U.S. economy got onto a virtuous cycle of growth and investment.

That growth and investment did lead the U.S. to import more, because we were growing faster than the rest of the world. So, the causality there would be we grow faster at home for domestic reasons, we pull in imports, the rest of the world is growing slowly because they don't have their domestic policy house in order, and so we get a big trade deficit.

But there is another causality, and this would be the causality of the last couple of years. When there were these major financial disturbances in the rest of the world, that was -- the channels were to us, and the channels were two different channels which had offsetting effects. One channel was the markets for our products collapsed. We'd sell anything that we thought we could sell throughout Asia because Asia was on its back.

The second channel, though, is a lot of money that was invested in Asian markets and emerging markets in Latin America came to the United States. And so we had money coming in because it was seeking to get out of the rest of the world, and we had a loss in market.

So, in that period of time, the causality was significantly from the rest of the world to us.

So, I think you have to accept that these things all occur simultaneously and understand that there were both foreign factors and domestic factors which played into our trade imbalance.

COMMISSIONER KRUEGER: Commissioner Wessel.

COMMISSIONER WESSEL: Good afternoon. Good to see you. I'd like to ask you a question about the model of trades.

MS. TYSON: Okay.

COMMISSIONER WESSEL: And the rule of law and basic standards. As you recall in the NAFTA negotiations, as we looked at entering into an agreement with Mexico we looked at the body of laws to understand what the competitive issues might be. There were many who believed that we should never enter into an agreement. There are some who believed that their basic structure of laws was appropriate, but it was a question of the enforcement of those laws. And, for

example, in the intellectual property community, as you may recall, in fact our IT community asked that Mexico upgrade their laws somewhat prior to entering into negotiations so that the rule of law, the concept of moving forward, would be acceptable in terms of the negotiations.

We've reached a point now where in terms of many of the laws, IT, et cetera, that we're willing to use trade sanctions -- trade sanctions to have those countries enforce their domestic laws. But when we look at labor and environment we are unwilling to have a similar set of circumstances, that we view those as either secondary issues or having less impact on the competitiveness of our economy. I'd like just your general view of whether those issues should be of some kind of differential. Whether it's appropriate to require that that country's laws be enforced, and how we might bridge the divide that currently exists in terms of moving forward on trade.

MS. TYSON: I think it's actually not just a good question it's really a profound question because the basic reality is that growing interdependence, whether we like it or not, inevitably requires that countries take parts of their systems and think about ways of making them a little more comparable. I just think that is the case. And, you know, we do it.

We've done it in intellectual property. We do it, for example, in financial markets. You know, the Basel agreement. And a number of things that have been suggested out of the financial crisis of the last couple of years have been as much as possible harmonized to common standards of transparency, the common standards of accounting, the common standards of SEC-type oversight, so that if you're an investor on the Hong Kong stock market and an investor on the Zurich stock market you understand that the same kinds of oversights that you feel exist in the U.S. stock markets exists there.

I know a lot of people are very disturbed by this and wish it weren't so. But I believe that it is so and will continue to be so, that we will see more and more of that in the next century.

Now, on the issue of labor and the environment I think that it may be that the thing about NAFTA versus doing it multilaterally is in the NAFTA case there was enough commonality of interest in getting this done that ultimately we could agree on setting up particular arrangements to try to make sure that laws were being enforced and that we talked over time to try to improve -- to achieve greater comparability in laws.

We have a problem right now that on labor there is virtually united opposition to the U.S. interest in getting these issues on the international agenda. Only it isn't true. I don't think what Professor Friedman said is true. In principal, we do have enforceable laws against products that incorporate child and prison labor. They're hard to enforce. We don't always know. We find out with a lag. But we actually do have them.

COMMISSIONER HILLS: Not on child labor.

MS. TYSON: That's right. On child it's one that's under discussion.

So, I would imagine over time -- see, I think we will ultimately move to having some additional regulations on child laws. Sort of jumping ahead. But it's very complicated because a lot of the countries that we trade with would prefer -- from their own sense of their interest is that it's not in their interest. And indeed, it may not be in their interest at the moment. So, we're going to have to find ways to negotiate.

You know, the U.S. ability to get something on labor or something on the environment or something on services, we're taking a very hard line against the developing countries on things which are deeply in their interest like getting rid of our textile apparel

quotas more quickly or getting rid of our anti-dumping laws which the rest of the world finds as a form of protection. So, we're not putting a lot of things on the table, and then we're insisting that we move onto this next set of issues which the rest of the world doesn't quite -- it's not quite there yet.

So, I do think that there is a lot of similarity between the notion -- once you break the barrier, say, "Yes, we're going to do SEC regulation and IT regulations," and environmental is really, I think, very similar. The labor issues are the most complicated of all, it seems to me, because they are much more involved in societies most basic sort of political institutions. It's not just an issue of government regulation. It's an issue of can you unionize? What is the role of the labor movement and political institutions in the economy? It's very complicated. So, I think you have to start with very specific things, like child labor, labeling for child labor. That kind of thing.

COMMISSIONER WESSEL: But is a basic standard as we look at -- and understanding the problems we have in the multilateral setting, but if we were to proceed with other free-trade agreements and we look at the rule of law as it applies to that, can we

expect that labor and environment should be covered under that rule of law?

MS. TYSON: My own view is that is a perfectly reasonable thing to do. I regret very much that that issue, along with other issues, led to the loss of fast-track authority by President Clinton. I think that it is appropriate to have those negotiations. And how they play out will depend on which partner you're negotiating with. But I think that's appropriate.

COMMISSIONER KRUEGER: Commissioner D'Amato.

COMMISSIONER D'AMATO: Thank you, Madame Chairman. I want to thank the panel, both of you, for your very topical testimony.

I have two -- two questions. The first for both of you has to do with China and the second has to do with this sustainability issue. On the China question. Mr. McEachron, you know, you've testified here in your testimony that you're impressed with the Chinese issuing a degree mandating legal software for all it's ministries. The question is implementation.

My question, then, in following the China issue for all these years on intellectual property agreements and all the renegotiation of those agreements, you know, it started to get, you know, kind

of repetitious. What evidence is there that the Chinese will adhere to the agreements that they sign? And do we give our leverage up, inside or outside the WTO? Where do we have our maximum leverage over the Chinese to ensure that they tried and that they begin adhering to the rule of law? Do we give our leverage up by being part of the WTO? Are we better off at exercising bilateral leverage, as we did the Japanese? I think we're concerned about leverage here, particularly when we see the Chinese not adhering to the agreements that they've signed with us. That's my first question.

MR. McEACHRON: Again, I think it may be in the area of intellectual property rights asking me to solve the Chinese riddle. I'm not prepared to give you a very definitive answer. I do agree that from our perspective, certainly, the history of compliance, not only obeying the letter of bilateral agreements, memorandum of understanding, that's been negotiated with the PRC on IPR and other issues does not leave anyone in our industry with a very satisfied feeling.

However, the feeling that we do have is that we're making incremental progress in that regard.

And it is very much the case that we're at a level of testing whether or not implementation of existing laws can occur. As an industry we do a fair amount of anti-

piracy work in the PRC. Five years ago we really couldn't do any. A few years ago we were trying to do enforcement work against factories owned by the People's Liberation Army that were churning out counterfeit CDs. So, in very small, but we think still important ways, we're making progress there.

As to how we would have maximum leverage inside or outside of that agreement, we -- as an industry we're very pleased with the TRIPs agreement, the trade related aspects of intellectual property rights is part of the GATT agreement, largely because it gave us a multilateral forum to resolve some trade disputes, where we could bring cases and it wasn't, as much as we like Special Section 301, which is a bilateral arm-twisting, if you will, a multilateral arm twisting, particular with a market as large and powerful politically as the PRC, I think the multilateral opportunity has more hope over the long term to see the kind of relationship to develop trust, transparency, and rule of law. I mean, go down the list of attributes that most people candidly would say would be missing in the implementation of those agreements now with the PRC.

I come down slightly on the side of WTO, with a proviso that we need to get as much as we can

going in, because it's going to be slow in the next couple of rounds getting additional concessions.

COMMISSIONER D'AMATO: Do we want to demand some kind of performance-based results before we go along with their inclusion?

MR. MCEACHRON: That's a tough one because, quite frankly, measuring performance of almost anything in the PRC is pretty unreliable. On performance based results in other countries with somewhat more transparent data collection we've seen the performance metrics manipulated fairly easily, and in the PRC our experience is Beijing can't reliably tell us what Shanghai is doing nor often tell Shanghai what to do on one of these agreements, that the progress we've made has been more the result of working with a local administrative agency in Shanghai or another provincial area, and securing their cooperation rather than working through the central government. So, I'd like to see some benchmarks, but I am certainly not prepared to tell you what they are on our industry yet. But bench marking has been helpful. It isn't the only thing we're going to need.

COMMISSIONER KRUEGER: Commissioner Hills.

COMMISSIONER D'AMATO: Do you have anything to add, I'd like to get Ms. Tyson's --

COMMISSIONER KRUEGER: Sorry.

COMMISSIONER D'AMATO: -- get her view on this.

MS. TYSON: My view is that we're better off with China inside for two reasons. Number one is the one that was already mentioned, mainly, I think, over time it's better to have the weight of the multilateral community with us. And I think on issues of piracy the weight of the multilateral community will be with us.

And then the second reason I think it's better to have them in is because I think that actually I've always believed that the process here of getting them in will actually speed their own transition to a more rules based system internally. They'll be forced to adjust their own rules faster. They've been doing some of that, but I think this would just be additional leverage.

I think that we have been negotiating this agreement for a very long time, and I think we actually have negotiated a very good agreement. I don't think we gave ourselves away cheaply. As a matter of fact, I really feel that if you look at the deal that we have managed to put together after, what, 20 years of negotiations, that it's not obviously to me why it's in China's interest. It's in China's interest if they want long-term reform and movement into the Internet.

There's a lot of pain for China involved in this transition, and they need to be willing to take the pain.

COMMISSIONER D'AMATO: I have one more
Madame Chairman.

I wanted to ask you, Ms. Tyson, on the scenario of sustainability --

MS. TYSON: Yes.

COMMISSIONER D'AMATO: -- we've had Mr. Rubin and Mr. Greenspan talk about this thing as unsustainable and not telling us what the bad things are that will happen as a result of that statement. When we talk about if the Chinese economy -- if the Asian economies come back strong and we have an impact on the dollar that drives stock somewhat down, the problem I have as a question is -- and I don't know the answer to, is the vulnerability of this debt laden consumer who's invested in this market, and if the dollar starts going down, the impact on the market, and given that herd mentality out there, might cause a severe downturn in the market, and that would effect consumer credit. And the question is does that -- the danger is with this unsustainability is that it will -- this high credit environment will cause the kinds of behavior that might -- might generate a crisis as a result of the vulnerability that both consumers and

businesses do have on the credit side, with the dollar going down, and then it appears that the market is tanking.

MS. TYSON: I have heard both Bob and the Chairman talk about this issue. I suspect that their concern would be that exactly as you said. There's a kind of vulnerability here. And the vulnerability is that the strength of consumer demand and investment demand is being driven to a significant extent by the sort of wealth effect of a much higher stock market. And if there are lots of ways that this could get into trouble.

One way is that there is, this didn't happen but it could have happened, you have one major player like Microsoft gets into trouble, people get nervous about technology stocks and they start selling them and that creates a herd mentality.

But it's coming entirely from a domestic based stock. But the concern about the international situation actually suggests that the channels of vulnerability would be different, and that would be that foreigners would begin to take their money out of the U.S. stock market and out of the U.S. bonds, into their own economies for investment purposes. That would bring the stock market appreciation right down, bring interest rates up, and of course once interest

rates start going up, that might in turn lead to further declines in the stock market, and then you kind of get them.

So, the concern is if this occurs gradually, if it's something that everybody can live with. But the issue is we have a vulnerability to a sudden correction. That's really my point.

COMMISSIONER KRUEGER: Commissioner Hills.

COMMISSIONER HILLS: I want to start with a correction of the record based upon my experience with the Chinese. I think we have to be careful when we say the Chinese never carry out any agreement that they enter into. I entered into a market opening agreement with them in January 1991 and they agreed in the five subsequent years to lower their tariffs by December 31 of each of those years. I left in '93, but I subsequently talked to my successors, and to a letter, without exception, the Chinese abided by that agreement.

Similarly, we entered into an intellectual property agreement, and they agreed in the future on a date certain to join the Berne convention. Prior to that date, they did join.

I think the problem that we've had with developing countries, China included, is that their capacity of enforcement taxes their experience and

their ability. And I think you're right that they are getting better, but it needs a lot of work. And I tend to agree with Laura Tyson that we are seeing the world, north and south, rich and poor, coming into convergence on a number of issues on the basis of their own interest. Not because we beat them up. But whether it's financial standards or accounting standards or legal standards, to attract investment countries must establish a climate that is investor friendly.

The question I wanted to pose, actually, is to Dr. Tyson. With the convergence that you mentioned and with which I agree, there are a whole host of issues that are involved in trade. We object to other countries' human rights records. How they treat their dissidents or rebels, depending on how they define them. Their ethnic rules, whether they treat them appropriately. Their weapon proliferation. Their labor laws. Their transparency. Their religious rules and who was given equal access to a host of social norms. And if all of these things are heaped on the back of a trade agreement and we believe that trade opening creates convergence, don't we step in on the circle right where we break it?

One might argue, for example, is it wise to have sanctions and refuse to trade with one because their rules in a whole number of areas are incompatible

with what we think the norm should be when we believe the trade, in fact, exports to them western values. And the first issue is aren't we our own worst enemy when we do that? I tend to think that China is an example of where we have exported western values to our own advantage in a very measurable and profound way.

But also with the rest of the world do we slow up their agreement with us on this range of social political issues where we do it unilaterally? In other words, if we don't have internationally agreed norms, isn't it premature to say we're going to have unilaterally imposed sanctions? Would we not be better, as we have seen, for example, in the environmental field where we have agreed to use sanctions with the Endangered Species Act because we have an accord with which we all agree.

To pick labor, which is sensitive on this commission, I would argue that the United States has not ratified the International Labor Organization's norms, nor are the norms multilaterally agreed to. That is an organization that has some potential. And if we could get an international agreement on labor norms, then it would be -- we could sit down and rationally decided whether trade was a good sanction in some circumstance.

But I'd like your views, particularly on the convergence. Are we our own worst enemy on convergence on this range of issues when we refuse to trade, if trade, in fact, is the great engine ringing us together?

MS. TYSON: Well, in general I share your perspective. I really do. But I want to make a few just distinctions here.

On the issue of sanctions I did hear the end of the discussion about South Africa. Now, as far as I understand the history of economic sanctions suggests that economic sanctions have basically -- if you take them vis-à-vis Yugoslavia or vis-à-vis Iraq or vis-à-vis Iran, they don't achieve their objective. What we're trying to get the country to do, the country doesn't do. It's either because you can't inflict enough pain because they tend to be unilateral, and when they're unilateral, they don't work. If they're multilateral, even then they sometimes don't work because you're hurting not the decision makers in the country, but you're probably going to inflict pain on the population, and the problem is the population doesn't have any leverage with the leadership anyway. That's the whole reason why there's a human rights problem.

So, they're very ineffective. They're entirely ineffective when they're unilateral. And they are frequently ineffective when they're multilateral.

But I would say that the evidence suggests South Africa is the exception to that observation. At least my understanding is that they -- you can make a credible argument that along with a number of other things going on, multilateral sanctions against South Africa were one factor that led to the end of apartheid.

Now, just because we might have one case which we believe fits, does not make a general case for sanctions.

On the issue of loading up a trade organization with a bunch of non-trade issues. I do worry about that, and I think that, frankly, that's why I like things like the Basel Accord. I like things which actually focus on a particular issue, bring the experts on that issue together from the country, and try to work out an agreement which is about that issue. And I think that is a much superior way of proceeding.

On the issue, though, one thing that I think I do have some difference with you is on the issue of labor in the following sense. You were talking about human rights issues and religious issues and political issues. The labor issue is a little

different because it has real economic content. I mean, that is, it goes to what Michael said, that somehow we said it's okay to talk about intellectual property because that has an economic effect, but it's not okay to talk about labor because it doesn't. Labor does have an economic effect. The difference in labor standards and labor -- degrees of labor organization and labor skills, all of those things do have an effect on trade.

So, all I would say is I agree with you that the world system is nowhere near a multilateral agreement on this, and I do not think that the U.S. should use unilateral sanctions to try to push the world to agreement because it won't work. It's ineffective. It hurts us. It doesn't change the behavior we're trying to change. I think we should continue to try to work with the rest of the world to get an agreed upon set of standards which we can accept as the multilateral principals, and then work from there.

MR. McEACHRON: Two quick points. First, if I left the Commission with the impression that it was my opinion or my association's or even my company's opinion that China never follows an agreement, I do stand corrected. That is not the case. The more important point that I hoped to make was that the

agreement that you make with China will have an implementation component. Perhaps that will be the most important thing. And that will be an extraordinarily difficult task over time.

COMMISSIONER HILLS: Absolutely. But China is not alone.

COMMISSIONER KRUEGER: The last question comes from Commissioner Lewis.

COMMISSIONER LEWIS: I'd like to ask Mr. McEachron how many employees does Microsoft have in total, and how many are overseas?

MR. McEACHRON: Thirty -- about 32,000 worldwide, half of which are overseas, the vast majority of which are local citizens. We have very few U.S. citizens employed abroad.

COMMISSIONER LEWIS: And the ones overseas do what kinds of activities?

MR. McEACHRON: Primarily sales and marketing. We have a couple of research and development centers. One in Cambridge. One in India. A third in Beijing affiliated with the Beijing University. Our product development happens a bit like a university faculty. We like to have people in close physical proximity. The cross-pollenization is extremely helpful.

COMMISSIONER LEWIS: The collegial atmosphere.

MR. McEACHRON: Yes. A little collegial atmosphere, and the fact that they can sit down at the same white board and draw their diagrams together. Even though we do teleconferencing and we travel and all of that, the ability, for example, just even to get a single group into one building, Microsoft research, which is not research -- product research, it's more voice recognition, natural speech patterns, all kinds of interesting people. Having them physically together so that they can bump into each other, exchange ideas, share resources. We think that's the same reason that universities, the best universities have faculties that are in close --

COMMISSIONER LEWIS: Your overseas people are not doing production?

MR. McEACHRON: Production?

COMMISSIONER D'AMATO: Yes.

MR. McEACHRON: Oh, manufacturing. We actually don't manufacture many of our own products. We do a little bit in Ireland. The manufacturing process. The stamping of the discs is an important part, but it's a decidedly low technology task compared with designing the software. We find a lot companies who are better punching out the discs on a factory

assembly line than we are, so we started selling off our manufacturing facilities years ago.

COMMISSIONER LEWIS: And that's being done where?

MR. McEACHRON: It's done in Singapore, Ireland, a little bit in Puerto Rico. There is still some in the United States. But, as well, consistent with that, the physical delivery of our product is becoming less and less important. It's being delivered without a physical transfer of goods, quite often. Already installed on someone's personal computer. Starting to download over the net. Internet. Or over private networks. So, we think the manufacturing component of putting a box of software on someone's desk, it is -- I don't want to sound callous about this, it's probably the least interesting aspect of our business, and something that confuses -- that when a national government asks us to come into a market and invest heavily, we don't build factories. We build an information industry. A partnership with people and ideas. It doesn't require a lot of bricks and mortar to do that. It does require some good telecommunications infrastructure, and an open one.

COMMISSIONER LEWIS: Thank you very much. Dr. Tyson, I have a couple of questions for you.

MS. TYSON: Okay.

COMMISSIONER LEWIS: The theory was twofold about the trade deficit. Number one, as we got the federal deficit down, the trade deficit would go down. We've seen that hasn't happened because savings and consumption have gotten worse and savings has gotten worse in the private sector.

MS. TYSON: Right.

COMMISSIONER LEWIS: But the fact is that the federal deficit did go down and the trade deficit went up.

MS. TYSON: The federal deficit went down. The private sector deficit went up. And the trade deficit went up. You could argue that basically what happened is that the overall U.S. deficit didn't go down, because although the Federal Government deficit went down, the private sector's deficit went up. We spent a lot and didn't save much.

COMMISSIONER LEWIS: Right. The theory, also, is that as the other countries' growth occurs greater than the United States, our trade patterns with them will change.

MS. TYSON: They will -- yes, they'll start to buy much more from us.

COMMISSIONER LEWIS: Hasn't the Chinese and Japanese trade with us basically been growing surpluses

even though there have been times when their growth has been greater than the United States' growth?

MS. TYSON: Yes, I want to say that that point about what happens to the U.S. trade deficit is an overall point. It's not a bilateral point. If you look at what happened before the Asian financial crisis, before '97, we had a growing trade deficit with China, but we had a shrinking trade deficit with the other east Asian economies, and what was happening was as the other east Asian economies became higher income, they lost their competitive advantage vis-à-vis China, and so we started to better.

COMMISSIONER LEWIS: With them, and they started to do worse with China.

MS. TYSON: Yes. So, I suspect that if we had no savings problem in the United States and we had a better private sector balance between savings and investment, we would still have a trade deficit with China and we would still have a trade deficit with Japan, for different reasons. For China, because we've -- given their development level and ours -- there's a lot of complimentary trade that goes on where we import a lot of products that become input into things with exports to other parts of the world.

And in the case of Japan we might continue to have a bilateral trade deficit. I think we probably

would. And that has to do, I think, with a different factor, which is really Japan tends to be much less import intensive than the United States, that's a result of a long period of protection in Japan and a limited amount of foreign investment in Japan. If we had more American companies operating big facilities in Japan, there would be more U.S. imports into Japan.

COMMISSIONER LEWIS: And my final question is a few years ago the Japanese government hinted that they might stop buying treasuries, and the next day or two the stock market went down several hundred points; do you remember that?

MS. TYSON: Yes. Well, I do remember they've done this occasionally.

COMMISSIONER LEWIS: How vulnerable is the United States to that kind of an action? And as our deficit keeps growing and the holding of treasuries increases, and as our domestic fiscal management is in surplus so we're issuing or buying back some of these treasuries, they're owning a larger share of the treasuries, how vulnerable do we become?

MS. TYSON: Well, first of all, I think the rest of the world has been diversifying into other U.S. assets. So, I think that part of what we see and will continue to see is foreigners are not just buying -- originally, when financial markets were considerably

less global, foreigners might have invested in the less risky or the least risky U.S. asset, which is a government security. But what we really have seen is that the world has become much more interested in our equity market and in our mutual funds and in our venture capital outlet.

So, I think that that's going to go on, this portfolio adjustment, adjustment to what foreigners hold of our financial assets.

On the issue of could a country deliver on a threat like that, I honestly think that in Japan, in particular, that really is not the case. And I think it will be very interesting watching the next few years, because of the big bang in financial liberalization in Japan, and because there's a huge maturing of a very large stock of savings in the Japanese Postal Savings Bank, it's quite possible that a lot of Japanese consumers who have seen abysmal returns on their investments in Japan, will start investing in U.S. securities and U.S. assets. So, I don't think the government of Japan could deliver on a threat like that.

I really don't. I don't. And nonetheless I think if foreign investors get spooked, the problem is what Alan Greenspan keeps saying is you can't predict these kinds of breaks in market psychology.

You only know them after the fact. If something changes market psychology, vis-à-vis the health of the U.S. economy or the health of the U.S. stock market, then you can have a rather sudden movement out. And it's not orchestrated by any individual. The financial shocks of Asia were not orchestrated by any individual, although some people wanted to blame it on George Soros or somebody like that. They were not.

COMMISSIONER LEWIS: Thank you very much.

COMMISSIONER KRUEGER: Okay. Thank you very much for coming. We appreciate your input. It's been a good morning.

(Whereupon, the hearing went off the record at 1:00 p.m.)

A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

(2:00 p.m.)

COMMISSIONER KRUEGER: Okay. There will be a couple more committee members coming in, but given that we've already imposed on you by asking you to wait a half an hour before we -- excuse me, we're trying to start it now.

At any event, first off, the main first thing is to thank you, A, for coming, which was already nice enough, and then, B, for being so patient when we ran behind.

As you know, the Trade Deficit Commission is charged with investigating the causes of the U.S. trade deficit, as it so says in the law, and then examining various policies that might or might not contribute to its reduction. And in that context we've asked you to come in and give us your views on the subject.

We're going to ask you each to limit your remarks to seven minutes each. There is a timer here.

And within those seven minutes make your opening statements and then I will open it up for questions from the commissioners, and of course you can elaborate, whatever it is that you wish to at that point. I'll call on you in the order you're listed in

on our program. And so the first would be Professor Michael Dooley.